

Message Text

CONFIDENTIAL

PAGE 01 MADRID 01145 01 OF 02 112119Z
ACTION EUR-12

INFO OCT-01 IO-13 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 DODE-00 PM-04 H-01
L-03 NSC-05 PA-01 PRS-01 SS-15 CEA-01 STR-04 /104 W
-----112213Z 013888 /73

P R 111847Z FEB 77
FM AMEMBASSY MADRID
TO SECSTATE WASHDC PRIORITY 8979
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
USMISSION EC BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
USMISSION GENEVA
AMEMBASSY THE HAGUE
AMEMBASSY LISBON
AMEMBASSY LONDON
AMEMBASSY LUXENBOURG
AMEMBASSY PARIS
USMISSION OECD PARIS
AMEMBASSY ROME
AMCONSUL BARCLEONA
AMCONSUL BILBAO
AMCONSUL SEVILLA

C O N F I D E N T I A L SECTION 1 OF 2 MADRID 1145

E.O. 11652: GDS
TAGS: ECON, EFIN, SP
SUBJECT: THE SPANISH ECONOMY - A NEW YEAR ASSESSMENT

REF: 76 MADRID 4579; 76 MADRID A-210

1. SUMMARY: AS SPAIN PROCEEDS ALONG THE DIFFICULT
ROAD OF POLITICAL EVOLUTION, THE ECONOMY REMAINS IN
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MADRID 01145 01 OF 02 112119Z

THE GRIPS OF STAGFLATION, WITH AN ACCOMPANYING CON-
TINUING SEVERELY NEGATIVE BALANCE OF PAYMENTS SITUATION.
DURING 1976, GROWTH IN REAL NATIONAL INCOME WAS NEARLY
STAGNANT AND UNEMPLOYMENT INCREASED, WHILE BOTH IN-
FLATION AND THE BALANCE OF PAYMENTS DEFICIT WORSENE
BEYOND EARLIER ESTIMATES. TOTAL OUTSTANDING FOREIGN
DEBT HAS RISEN TO ABOUT \$12 BILLION WHILE OFFICIAL

GOLD AND FOREIGN EXCHANGE RESERVES HAVE FALLEN BY NEARLY \$1 BILLION (ALTHOUGH A CUSHION OF \$4.9 BILLION STILL REMAINS). WHILE MANY SPANISH BUSINESSMEN AND BANKERS AND POLITICIANS OUTSIDE THE GOVERNMENT COUNSEL EARLY ACTION TO CURB INFLATION AND RIGHT THE BALANCE OF PAYMENTS, THE PRESENT GOVERNMENT IS RELUCTANT TO INSTITUTE SUCH MEASURES NOW FOR FEAR THAT INCREASED UNEMPLOYMENT AND SOCIAL TENSIONS COULD UPSET THE MOVE TO FREE ELECTIONS EXPECTED IN MAY AND PERHAPS JEOPARDIZE ITS OWN POLITICAL FUTURE. MORE LIKELY AT PRESENT IS SOME INCREASE IN PUBLIC INVESTMENT TO STIMULATE EMPLOYMENT, COUPLED WITH CONTINUATION OF SOMEWHAT MORE AGGRESSIVE TAX COLLECTION AND INCREASED ENERGY PRICES TO DAMPEN THE INFLATIONARY FISCAL IMPACT. THE ECONOMIC OUTLOOK FOR 1977 IS OF PRESENT TRENDS IN THE FIRST SEMESTER, WITH THE POSSIBILITY OF MORE RAPID DETERIORATION, AND WITH THE GOVERNMENT HOPING THAT ELECTIONS WILL BRING A SITUATION IN WHICH THE GOVERNMENT THEN IN POWER CAN GAIN INVESTOR CONFIDENCE AND PUBLIC SUPPORT FOR A STABILIZATION EFFORT COUPLED WITH STRUCTURAL REFORMS. END SUMMARY.

2. SPAIN ENTERS 1977 WITH ITS ECONOMY STILL IN A STATE OF STAGFLATION AND WITH LITTLE PROSPECT FOR ANY SIGNIFICANT CHANGE FOR THE BETTER IN THE SITUATION OVER AT LEAST THE NEXT SIX MONTHS. DURING 1976, GROSS CAPITAL FORMATION FELL BY 1.4 PERCENT ON THE HEELS OF AN EVEN LARGER PERCENT DECLINE THE YEAR BEFORE. A SMALL INCREASE IN REAL GDP, SLIGHTLY UNDER 1.7 PERCENT, RESULTED

CONFIDENTIAL

PAGE 03 MADRID 01145 01 OF 02 112119Z

ONLY FROM INCREASING PRIVATE CONSUMPTION AND GOVERNMENT EXPENDITURE. AT THE SAME TIME, INFLATIONARY PRESSURES - PRINCIPALLY FROM GENEROUS WAGE SETTLEMENTS AND PERMISSIVE MONETARY POLICY - INCREASED, PUSHING THE COST OF LIVING INDEX UP BY NEARLY 20 PERCENT FOR THE YEAR. THE BALANCE OF PAYMENTS DEFICIT ON CURRENT ACCOUNT ROSE TO ABOVE \$4 BILLION BY YEAR END (COMPARED WITH DEMYBILLIO, FOR 1975) DUE TO A RECORD TRADE DEFICIT, REDUCED EARNINGS FROM TOURISM AND WORKERS' REMITTANCES, AND INCREASED ROYALTY PAYMENTS. IN ADDITION TO GOVERNMENT DRAWING ON THE \$1 BILLION LOAN EXTENDED LAST AUGUST BY A CONSORTIUM OF PRIVATE BANKS, PRIVATE SPANISH BORROWING ABROAD RESERVES TO FALL BY NEARLY \$1 BILLION. AT \$419 BILLION, FOREIGN EXCHANGE RESERVES ARE STILL RELATIVELY HIGH COMPARED TO ANNUAL IMPORT LEVELS, BUT COULD BE DISSIPATED RAPIDLY IF STEPS ARE NOT TAKEN TO CORRECT THE CHRONIC AND SEVERE DEFICIT PROBLEM. TOTAL FOREIGN DEBT, BOTH OFFICIAL AND PRIVATE, IS ESTIMATED TO HAVE REACHED ABOUT \$12 BILLION, AN IN-

CREASE OF OVER \$3 BILLION DURING 1976.

3. WHILE THERE IS VIRTUALLY UNANIMOUS ACCORD IN DESCRIBING SPAIN'S ECONOMIC DIFFICULTIES, THERE IS SOME DISAGREEMENT OVER THE BASIC UNDERLYING CAUSES, AND CONSIDERABLE CONTROVERSY OVER THE DIRECTION AND TIMING OF CORRECTIVE MEASURES. THERE IS SOME ARGUMENT OVER THE ACCURACY OF OFFICIAL COST OF LIVING AND UNEMPLOYMENT FIGURES, BUT THERE IS NO DOUBT THAT INFLATION HAS BEEN IN DOUBLE DIGIT FIGURES FOR THE PAST FOUR YEARS AND INCREASED IN 1976, AND THAT UNEMPLOYMENT (ALTHOUGH STILL LOWER THAN IN MANY COUNTRIES) HAS AT LEAST DOUBLED DURING THE PAST THREE YEARS. IT IS GENERALLY ACCEPTED THAT SPAIN HAS DELAYED LONGER THAN IT SHOULD NECESSARY ADJUSTMENTS TO THE DRAMATIC 1974 INCREASE IN ENERGY PRICES. DURING THE PAST THREE YEARS, THE GOVERNMENT ABSORBED A LARGE SHARE OF THE OIL PRICE INCREASE BY
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 MADRID 01145 01 OF 02 112119Z

FOREGOING TAXES ON PETROLEUM PRODUCTS AND BY FINANCING ITS RESULTING BUDGETARY DEFICITS BY BORROWING. THE DEFICITS ADDED TO ALREADY STRONG INFLATIONARY PRESSURES RESULT FROM GENEROUS WAGE SETTLEMENTS AND FROM PERMISSIVE MONETARY POLICY. THIS HAS OCCURRED WHILE TOURISM HAS LEVELLED OFF, DEMAND FOR EMIGRANT WORKERS IN WESTERN EUROPE HAS DRIED UP, AND DOMESTIC INVESTMENT IS INHIBITED BY FEARS AND UNCERTAINTIES INHERENT IN THE CHANGING POLITICAL SITUATION AS WELL AS CONTINUING AND NOW INCREASING INFLATION.

CONFIDENTIAL

NNN

CONFIDENTIAL

PAGE 01 MADRID 01145 02 OF 02 112135Z
ACTION EUR-12

INFO OCT-01 IO-13 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 DODE-00 PM-04 H-01
L-03 NSC-05 PA-01 PRS-01 SS-15 CEA-01 STR-04 /104 W
-----112212Z 014030 /73

P R 111847Z FEB 77

FM AMEMBASSY MADRID

TO SECSTATE WASHDC PRIORITY 8980
INFO AMEMBASSY BONN
AMEMBASSY BRUSSELS
USMISSION EC BRUSSELS
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN
USMISSION GENEVA
AMEMBASSY THE HAGUE
AMEMBASSY LISBON
AMEMBASSY LONDON
AMEMBASSY LUXENBOURG
AMEMBASSY PARIS
USMISSION OECD PARIS
AMEMBASSY ROME
AMCONSUL BARCELONA
AMCONSUL BILBAO
AMCONSUL SEVILLA

C O N F I D E N T I A L SECTION 2 OF 2 MADRID 1145

4. SPAIN IS FACED WITH A COMMON AND UNPLEASANT DILEMMA. STATED MOST STARKLY, ACTIONS WHICH THE GOVERNMENT MIGHT TAKE TO REDUCE THE RATE OF INFLATION AND BALANCE OF PAYMENTS DEFICIT WOULD ALSO TEND IN THE SHORT TERM TO RESTRICT ALREADY LAGGING PRODUCTION AND INCREASE UNEMPLOYMENT. THE PURELY CONVENTIONAL PACKAGE OF BELT-TIGHTENING MEASURES NORMALLY PRESCRIBED WOULD INCLUDE HIGHER TAXES, PUBLIC EXPENDITURE RESTRAINT, DEVALUATION
CONFIDENTIAL

CONFIDENTIAL

PAGE 02 MADRID 01145 02 OF 02 112135Z

OF THE PESETA, A RESTRICTIVE MONETARY POLICY, AND WAGE RESTRAINT. IN THE CASE OF SPAIN, WAGE RESTRAINT WILL BE DIFFICULT TO ACHIEVE; AND MARKET PRICES ARE ALREADY DISTORTED BY GOVERNMENTAL CONTROLS AND SUBSIDIES AND BY THE OLIGOPOLISTIC NATURE OF SPANISH INDUSTRY. THEREFORE, A COUPLING OF WAGE AND PRICE CONTROLS MIGHT WELL HAVE TO BE PART OF A STABILIZATION PACKAGE AT LEAST INITIALLY. IN THE LONGER RUN, AND AS SOON AS POSSIBLE, CONTROLS SHOULD BE ABANDONED AND PRICES SHOULD BE PERMITTED TO FIND THEIR OWN LEVEL SO THAT THE MARKET CAN DISTRIBUTE RESOURCES AND OPTIMIZE PRODUCTION. ALSO IN THE LONGER RUN, MORE BASIC STRUCTURAL CHANGES SHOULD BE MADE, INCLUDING REDUCTION OF CONTROLS AND SUBSIDIES THROUGHOUT THE ECONOMY TO IMPROVE COMPETITION AND EFFICIENCY, MEASURES TO IMPROVE PRODUCTIVITY IN THE AGRICULTURAL SECTOR, RATIONALIZATION OF GOVERNMENT ENTERPRISES, AND BASIC TAX REFORM TO INCREASE GOVERNMENT REVENUE, PROVIDE A MORE EQUITABLE TAX BURDEN AND MAKE POSSIBLE THE USE OF FISCAL POLICY AS AN EFFECTIVE ECONOMY TOOL. INDEED, WITHOUT A CREDIBLE

COMMITMENT TO BASIC STRUCTURAL CHANGES SUCH AS TAX REFORM PUBLIC AGREEMENT ON A STABILIZATION PROGRAM NECESSARILY INCLUDING WAGE RESTRAINT WILL BE UNOBTAINABLE.

5. THE SPANISH GOVERNMENT OBVIOUSLY ALSO HAS GOALS AND RESTRAINTS THAT GO BEYOND PURELY ECONOMIC CONSIDERATIONS. DESPITE URGINGS FROM SOME INFLUENTIAL BUSINESSMEN AND BANKERS AND ALSO POLITICIANS OUTSIDE THE GOVERNMENT - PARTICULARLY FROM THE ALIANZA POPULAR BUT ALSO FROM THE CENTRO DEMOCRATICO AND ELSEWHERE - TO ACT QUICKLY BEFORE INFLATION AND THE BALANCE OF PAYMENTS WORSEN, THE GOVERNMENT SEEMS UNWILLING TO ACCEPT BEFORE ELECTIONS EXPECTED IN MAY THE REAL RISK OF INCREASED UNEMPLOYMENT AND SOCIAL TENSIONS WHICH SEVERE BELT-TIGHTENING MEASURES WOULD ADD TO THE ALREADY FRAGILE
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 MADRID 01145 02 OF 02 112135Z

POLITICAL SITUATION. THE PRESENT TRANSITIONAL GOVERNMENT IS ELABORATING A DEVELOPMENT PLAN FOR THE MEDIUM AND LONG-TERM, AND CONCEIVABLY IT MAY BE FORCED BY EVENTS, OR DECIDE ON ITS OWN, TO ADDRESS SPAIN'S SERIOUS ECONOMIC PROBLEMS FRONTALLY BEFORE MAY. IN ADDITION, IT IS EXPECTED TO TAKE FRONTALLY BEFORE MAY. IN ADDITION, IT IS EXPECTED TO TAKE SOME NEAR-TERM STEPS. HOWEVER, AT PRESENT READING IT SEEMS HIGHLY UNLIKELY TO DO MORE PRIOR TO ELECTIONS THAN PERHAPS ALLOW ENERGY PRICES TO RISE SOMEWHAT, CONTINUE TO LET THE PESETA FLOAT DOWNWARD GRADUALLY, CONTINUE EFFORTS TO IMPROVE TAX COLLECTION AND INCREASE SOME TAXES, AND HOLD THE ANNUAL INCREASE IN MONEY SUPPLY NEAR THE RATE OF INFLATION. (THE DEPUTY DIRECTOR OF THE BANK OF SPAIN HAS TOLD US THAT THE TARGET FOR MONEY SUPPLY INCREASE IN 1977 IS 21PERCENT, THE SAME AS IN 1976.) AT THE SMAE TIME, IT WILL ALMOST CERTAINLY INCREASE PUBLIC CAPITAL EXPENDITURES SOMEWHAT TO STIMULATE THE ECONOMY AND CREATE JOBS IN SECTORS AND REGIONS HARDEST HIT BY UNEMPLOYMENT, TRYING TO MODIFY THE INFLATIONARY FISCAL IMPACT BY IMPROVED TAX COLLECTION AND INCREASED BUDGETARY REVENUE FROM HIGHER ENERGY PRICES AND PERHAPS TAXES. THE PRESENT POLITICAL LEADERS UNDOUBTEDLY HOPE THAT ELECTION OF A MODERATE GOVERNMENT IN MID-YEAR WILL HELP RESTORE INVESTOR CONFIDENCE, AND WITH THE ESTABLISHMENT OF FREE TRADE UNIONS, WILL PERMIT A DIALOGUE TO DEVELOP A CONSENSUS IN SUPPORT OF THE NEEDED STABILIZATION PROGRAM AND STRUCTURAL REFORMS. SKEPTICS IN BUSINESS, BANKING, POLITICAL AND MEDIA CIRCLES ARGUE THAT THE CURRENT GOVERNMENT IS IN AS GOOD OR BETTER A POSITION TO DIALOGUE AND ACT THAN THE POST-ELECTION GOVERNMENT WILL BE, AND THAT THE ADJUSTMENTS WILL BE THE GREATER AND MORE PAIN-

FUL FOR HAVING WAITED. AT THE LEAST, MONEY SUPPLY COULD BE RESTRICTED MORE THAN IS PLANNED, GOVERNMENT SPENDING COULD BE HELD DOWN, THE EXCHANGE RATE COULD BE PERMITTED TO FLOAT DOWNWARD MORE QUICKLY, AND THE DIALOGUE WITH CONFIDENTIAL

CONFIDENTIAL

PAGE 04 MADRID 01145 02 OF 02 112135Z

LABOR, POLITICAL LEADERS, AND IMF ON A RATIONAL FUTURE PROGRAM COULD BE STARTED. ON THE OTHER HAND, SOME WITHIN THE GOVERNMENT MAY BE ARGUING IN FOR A MORE EXPANSION-ARY APPROACH THAN THAT DESCRIBED ABOVE AS THE DESIRABLE PRE-ELECTION COURSE.

6. IN THE LIKELY ABSENCE OF STRONG GOVERNMENT ACTION IN THE FIRST HALF OF 1977, THE ECONOMIC OUTLOOK FOR THE YEAR IS, AT BEST, FOR A CONTINUATION OF PRESENT TRENDS. REAL ECONOMIC GROWTH WILL MOST PROBABLY REMAIN UNDER 2 PERCENT, AT LEAST THROUGH THE FIRST HALF OF THE YEAR, AS UNEMPLOYMENT GRADUALLY INCREASES. WITH WAGE SETTLEMENTS CONTINUING IN THE 25-30 PERCENT RANGE, NO EFFECTIVE CONTROL ON PRICES EXCEPT FOR A FEW BASIC COMMODITIES, ALIKELY PUBLIC SECTOR DEFICIT AT LEAST EQUAL TO LAST YEAR'S \$1.5 BILLION, AND CONTINUED PERMISSIVE MONETARY POLICY, INFLATION WILL PROBABLY CONTINUE AT LEAST ITS PRESENT RATE, IF IT DOES NOT GO HIGHER. WITH AN INCREASED OIL BILL OF \$400 TO \$500 MILLION DUE TO THE RECENT OPEC HIKE IN PETROLEUM PRICES, THERE IS NO REASON TO BELIEVE OTHER FACTORS WILL OPERATE TO REDUCE THE \$4 BILLION CURRENT ACCOUNT BALANCE OF PAYMENTS DEFICIT. INCREASED CAPITAL FLIGHT COULD PRODUCE A MORE RAPID DETERIORATION IN ITS OVERALL BALANCE OF PAYMENTS. IN ANTICIPATION OF THE DEFICIT OF AROUND \$4 BILLION, THE GOVERNMENT IS SEEKING MAJOR COMMITMENTS FOR FOREIGN CREDITS FROM SOME OF THE MIDDLE EAST OIL PRODUCERS, AND DOUBTLESS WILL PRESS FOR OTHER LOANS ELSEWHERE AS THE YEAR PROGRESSES.

7. ASSUMING NO SURPRISINGLY STRONG ACTION NOW, WHATEVER GOVERNMENT IS IN OFFICE AFTER ELECTIONS WILL INHERIT AN ECONOMY WITH SERIOUS MID-TERM STRUCTURAL DISTORTIONS AND DIFFICULT IMMEDIATE PROBLEMS. PROSPECTS WILL BE BRIGHTER IF THAT GOVERNMENT IS ONE THAT - THOUGH REPRESENTATIVENESS, ABILITY, AND CONFIDENTIAL

CONFIDENTIAL

PAGE 05 MADRID 01145 02 OF 02 112135Z

CONVICTIONS - CAN GAIN THE CONFIDENCE AND SUPPORT OF BOTH CAPITAL AND LABOR TO SHARE THE BURDEN OF

STABILIZATION AND REFORM.STABLER

CONFIDENTIAL

NNN

Message Attributes

Automatic Decaptioning: X
Capture Date: 01-Jan-1994 12:00:00 am
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ECONOMIC CONDITIONS, INFLATION, BALANCE OF PAYMENTS
Control Number: n/a
Copy: SINGLE
Sent Date: 11-Feb-1977 12:00:00 am
Decaption Date: 01-Jan-1960 12:00:00 am
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 22 May 2009
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1977MADRID01145
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: GS
Errors: N/A
Expiration:
Film Number: D770050-0218
Format: TEL
From: MADRID
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1977/newtext/t19770250/aaaabszgz.tel
Line Count: 333
Litigation Code IDs:
Litigation Codes:
Litigation History:
Locator: TEXT ON-LINE, ON MICROFILM
Message ID: c0f1f5c7-c288-dd11-92da-001cc4696bcc
Office: ACTION EUR
Original Classification: CONFIDENTIAL
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 7
Previous Channel Indicators: n/a
Previous Classification: CONFIDENTIAL
Previous Handling Restrictions: n/a
Reference: 76 MADRID 4579, 76 MADRID A-210
Retention: 0
Review Action: RELEASED, APPROVED
Review Content Flags:
Review Date: 23-Nov-2004 12:00:00 am
Review Event:
Review Exemptions: n/a
Review Media Identifier:
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
SAS ID: 3344177
Secure: OPEN
Status: NATIVE
Subject: THE SPANISH ECONOMY - A NEW YEAR ASSESSMENT
TAGS: ECON, EFIN, SP
To: STATE
Type: TE
vdkgvwkey: odbc://SAS/SAS.dbo.SAS_Docs/c0f1f5c7-c288-dd11-92da-001cc4696bcc
Review Markings:
Margaret P. Grafeld
Declassified/Released
US Department of State
EO Systematic Review
22 May 2009
Markings: Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009